The Economic Policies of China, India and the Washington Consensus: An Enlightening Comparison

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Abstract

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Introduction

China and India have each followed different development paths. The policy settings that have provided the context for each country’s development have also differed considerably from each other and from those of the Washington Consensus -- the name for the policies imposed by the International Monetary Fund and the World Bank on countries that require their assistance.

This paper analyses the economic policies of China and India, and then considers the impact of the Washington Consensus policies imposed by the IMF on Latin America and Africa in the wake of the debt crisis of 1982, on East Asia in the late 1990s and, most recently, upon Argentina. It analyses the grossly unjust socialisation of private sector debt which the Fund’s policies have facilitated and reflects upon the remarkable inability of the Fund to reinvent itself and to match its practices to its rhetoric.

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**China's and India’s Economic Policies**

China and India have travelled utterly different development paths, supported in each case by quite different policy settings, and political systems. Yet each country has enjoyed extraordinary and sustained growth. China has distinctly outperformed India, but viewed separately, each country’s achievements are exceptional. For 25 years China has averaged annual growth approaching 10%, while India’s economy has grown at between 5% and 6% for the same period.¹

China is today the second largest economy in the world in purchasing power parity (PPP) terms, the terms that economists generally accept are best used for comparative purposes, and the fourth largest economy in unadjusted US dollar terms. China’s GDP on a PPP basis in 2006 was US$10,147 billion and its per capita GDP on the same PPP terms was US$7,722. This compares to US$12,955 billion and US$43,223 for the US and $4,232 billion and US$3,802 for India.² China is clearly a considerable way ahead of India on these rough gross measures today.

If the same policies had worked in China and India and were the opposite of those of the Washington Consensus we would have a neat, simple story. But real life is rarely neat. Indeed, the inherent and deeply embedded diversity of nations is part of the problem with the Washington Consensus – its one-size-fits-all mindset, in truth fits no one.

The primary differences between the two countries has lain in their development paths and in the role of government in their economies.

China has followed the classic development path of moving from an agriculture-based economy into manufacturing, initially simple manufacturing such as clothing and


² IMF, World Economic Outlook, October 2007.
footwear, and then ever more sophisticated manufacturing, to the point that today China is virtually the ‘factory for the world’, the way the North of England was in the early years of the industrial revolution. The ‘final’ stage on this classic path, followed by developed countries, is the further transition into a services-based economy.

India, on the other hand, has pursued an utterly different path, moving directly from agriculture into services, while manufacturing activity has remained relatively constant. This relatively unique path has been supported by a number of factors including:

(i) the establishment in the early days of Indian independence of a number of world class institutes of technology,

(ii) the computing and telecommunications revolutions, which have generated the software development industry and allowed India to provide software, call centre, back office, and other services to the rest of the world on a remote basis, and

(iii) the widespread usage of the English language in India.

The other major difference difference is that India has been a traditional mixed economy whereas China for most of the past 25 years has been a command economy. Even today China is perhaps best described as a soft authoritarian system. Certainly it is a very different political system to India’s democracy. For an example of the role of the state in China’s economy consider that, as recently as 2004, state-owned enterprises accounted for over 50% of China’s GDP and over 40% of its exports.

These different paths and systems have been supported and reinforced by the differences between the financial systems in each country. China has retained state control of its financial sector and has used its control over financial flows to manage the economic cycle and to direct funds to priority sectors of the economy. India has relatively low levels of state ownership generally and of state control of the financial sector in particular.³ Accordingly, its financial sector has not provided government with a tiller with which to direct, and control, the economy as has China’s.

³ Ghosh.
These different paths are also the result of widely different investment levels in each country. Investment has fluctuated between 35 and 44% of GDP in China over the past 25 years. In India investment has only been at 20 to 26% of GDP. Within these divergent overall investment levels, the differences in investment in infrastructure and inward investment from abroad have been even more stark. For instance, in the 1990s Chinese investment in infrastructure represented 19% of GDP compared to only 2% in India. Much is often made of China’s large inflows of foreign direct investment and certainly the inflows of FDI into China far exceed those into India. With respect to FDI, China has been well served by its diaspora – the source of much of the funding that has flowed into China and a condition unique to the country. Yet FDI has accounted for only about 5% of GDP in China since 1990 and the critical investment in both nations has been funded internally. In the past few years, the foreign investment inflows into China have mainly supported China’s holdings of foreign reserves. Furthermore, inflows into India are increasing rapidly, by 250% between 2005 and 2006 (US$6.7bn in 2005 to 16.9bn in 2006) as more and more companies from developed countries seek to fulfill more of their IT and business processing needs in India.

China is significantly ahead of India on many measures of its education system. In India 57% of young people were in secondary school in 2005. In China the figure was 74%. Furthermore in China girls are as likely to be in school as boys. In India boys gain far more of the educational opportunities. This is reflected in literacy rates. In China 99% of young women between 15 and 24 are literate, in India the figure is only 65%.

Education is critical for growth. China’s investment in education means that its deep pool of agricultural workers have been able to make the transition into manufacturing jobs

4 Ghosh.
5 Ghosh.

http://law.bepress.com/unswwps-flrps09/art22
because their education has enabled the transition. This large agricultural workforce able to supply labour to manufacturing industry, and equipped to do so by massive state investment in education -- not a condition for development repeated in many developing states.\(^9\)

China has also been more successful than India in reducing poverty. Unofficial estimates are that about 12 per cent of China’s population live below the poverty line, compared to around 30 per cent of India’s.\(^10\)

China’s lead over India in education and health is set to widen. According to Premier Wen Jiabao’s state-of-the-nation address in March, 2008, the central Chinese government quadrupled health spending in 2007 and lifted spending on education by 76%. The Premier promised to lift health spending a further 25% this year, and education spending a further 45% and also promised steep increases in social welfare spending. These expenditure increases have been made possible by sharp increases in government revenues, up nearly 35% in 2007.\(^11\)

There are few investments that generate as strong returns for a developing nation as investing in the health and education of their children. China’s current spending priorities suggests it understands this, deeply. As Susan George wrote nearly 20 years ago, “The IMF cannot seem to understand that investing in … [a] healthy, well-fed, literate population … is the most intelligent economic choice a country can make.”\(^12\) Recent IMF practice suggests it is still to learn this lesson.

**The Washington Consensus Policies**

The focus of the Washington Consensus policies has been to grow the debtor’s economy, so as to alleviate poverty within the country and generate sufficient foreign exchange

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\(^10\) Ghosh.


\(^12\) Susan George, *A Fate Worse Than Debt*, (New York: Grove Weidenfeld, 1990), pp. 143, 187, 235
resources to stay current on its debts. It has been taken as axiomatic that higher growth rates lead to less poverty. The policies imposed to achieve these goals typically included:

- reductions in the budget deficit to limit inflation, and the need for foreign borrowing,
- limits on domestic credit expansion to control inflation,
- exchange rate devaluations to discourage imports and encourage exports, and
- generally a much reduced role for government and a much increased role for markets.

Other Washington Consensus policies imposed on debtors, at times, included (i) higher income and sales taxes, (ii) higher charges for state-produced goods and services such as electricity and water, (iii) privatisation of state-owned companies, (iv) deregulation of the labour market, and (v) reform of tariffs and import quota regimes. These policies have been criticised for their adverse effect on economic growth and their devastating effect upon the living standard of the local people, particularly the poor.13

Another explicit aim, and effect, of the Washington Consensus policies has been to reduce protectionism on the basis of a belief that economic growth is promoted through unilateral tariff cuts and reductions in import restrictions.

To understand how the IMF came to have, as its primary role, the direction of the economies of debtor nations in crisis and the implementation, therefore, of the Washington Consensus, it is necessary to understand its history.

**Some History**

The IMF was founded, along with the World Bank, in 1945 to, in the words of its website,

> “promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of

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employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment.”¹⁴

This is a reasonable summary. But the website proceeds,

“Since the IMF was established its purposes have remained unchanged but its operations—which involve surveillance, financial assistance, and technical assistance—have developed to meet the changing needs of its member countries in an evolving world economy.”

At best, this is spin.

The Fund’s purposes have changed. They changed in the 1970s when most developed countries moved away from fixed, to floating, exchange rates and the core function of the Fund, the maintenance of exchange stability, was ceded by governments to the market.

The Fund’s operations today do involve surveillance and financial and technical assistance, but these operations are primarily in the service of the prevention and management of developing country financial crises, not exchange stability.

The Fund performed a useful function throughout the 1950s and 60s, which were periods of sustained growth in much of the world. But the Fund’s original purpose largely disappeared in the 1970’s, and so, by the end of the decade, it was an organisation with a much reduced mission. This all changed in late 1982 when the debt crisis engulfed Africa and Latin America. The crisis gave the Fund the chance to reinvent itself as the manager of developing country crises. Relatively quickly the IMF came to discharge the critical role in the management of the debt crisis throughout the 1980s: directing the debtor nations’ economic policies. Debtors needed new money, to at least service interest. Creditors, understandably, wanted some assurance that the debtor’s economic policies that had contributed to the crisis had been changed. The commercial banks had firm views on the need for economic austerity by countries whose debt they were rescheduling. Yet considerations of national sovereignty made direct commercial bank involvement in the setting of local economic policies a political impossibility. The IMF

was ideally placed, as an apparently independent international financial institution to determine and monitor the economic policies, going forward, of the debtor nations.\textsuperscript{15} These policies imposed by the IMF and the World Bank, and supported by the US Treasury, came to be known as the Washington Consensus as all three bodies are headquartered in Washington, D.C.

This policy flies in the face of the experience of OECD countries. Britain in the nineteenth century, and the United States in the twentieth century, promoted free-trade “because they were the most efficient producers of the highest value-added goods. They did not become so through free trade; they protected themselves for decades in order to achieve that end.”\textsuperscript{16}

John Kenneth Galbraith wrote of this nineteenth century protectionism in these terms,

> For Britain, the industrially most advanced of countries, free trade was of obvious advantage, and like laissez-faire, it acquired a strong theological aura. In Germany and the United States, on the other hand, economic interest was better served by tariffs. Accordingly, the most respected economists in those countries ... spoke vigorously for protection for their national ‘infant industries’ ... from the products of the British colossus.\textsuperscript{17}

Free trade and laissez-faire economics do indeed attract a theological aura; as do the economic theories of the IMF.\textsuperscript{18} Ultimately, like all matters religious, one embraces the theology of the IMF by a leap of faith, not logical reasoning. The consequences of this theology since 1982 was literally a matter of life or death for millions of people.

\textbf{The Debt Crisis of 1982}

\textsuperscript{15} But only at the cost of resentment from within the debtor nations: remarks of Lee C Buchheit, in “Comity, Act of State, and the International Debt Crisis: Is There an Emerging Legal Equivalent of Bankruptcy Protection for Nations?”, Proceedings, Seventy-Ninth Annual Meeting, The American Society of International Law, 126 at 135.


\textsuperscript{17} Galbraith, \textit{The Culture of Contentment} (Bostodfn: Houghton Mifflin, 1992) at 46.

In the early years of the debt crisis the Fund severely underestimated its magnitude\(^\text{19}\) and the Fund’s policies did little to alleviate the crisis. The IMF policy prescriptions for Africa and Latin America meant that the 1980s were a lost decade. A decade in which net capital flows from these nations were northbound. A decade in which infrastructure crumbled. A decade, in Sub-Saharan Africa, in which life expectancy at the decade’s end was shorter than at the beginning.\(^\text{20}\)

The debt crisis was eventually relieved for the banks by the Brady Restructurings of the early 1990s in which the loans were converted into tradable bonds, with security for the repayment of principal and 12 to 18 months of interest repayments, and upon which some debt relief was granted. The Brady process did less for the debtor nations than for the banks but brought some modest relief and encouraged genuinely new capital inflows into the region. Of particular importance in terms of the contribution of the IMF, is that the Brady Plan was devised initially in Sao Paulo and Mexico City and given the imprimatur and support of the U.S. Treasury.\(^\text{21}\) The fingerprints of the IMF were nowhere to be found on the only creative measure brought to bear on the worst international economic crisis since World War II.

In mid-to-late 1997 a succession of East Asian countries ran out of foreign exchange reserves with which to defend the value of their currencies in the markets. The currencies of Thailand, Indonesia, Malaysia, and finally Korea, collapsed and foreign capital fled from the region.

**The Asian Crisis of 1997**

Asia’s was a fundamentally different crisis from the debt crisis of 1982 or Mexico’s peso crisis of 1994-95 in that the great majority of the troublesome indebtedness was of the private, not the public or quasi-public sector and it was not a crisis of over-consumption.


The Latin American nations had been borrowing, in part, to fund general government budgets. The East Asian governments had not been similarly seduced. Their fiscal policies were prudent. In the words of Laurence Meyer, a member of the Board of Governors of the US Federal Reserve System,

“By conventional standards, the monetary and fiscal policies of the developing Asian economies prior to the crisis were largely disciplined and appropriate. … consumer price inflation … was relatively subdued [and] fiscal policy also appears to have been disciplined.”

Asia’s crisis was primarily a crisis of inadequate local prudential regulation and inadequate confidence in the region by global capital. It was a contractionary crisis in which the largest problems were the exodus of global capital and loss of confidence in the region which led to a steep decline in economic activity.

Notwithstanding all of these differences, the IMF waded into Asia imposing the Washington Consensus policies it believed had worked in Latin America in the 1980s and Mexico in 1995 – prescriptions of budgetary tightening and austerity. Austerity is always bad policy for a contractionary crisis. It is utterly ineffective in encouraging contracting economies to expand.

At the time the Nobel laureate, Joseph Stiglitz, was the Chief Economist of the World Bank and he spoke out repeatedly to highlight the fundamental error in the Fund’s response to the Asian crisis. Joe Stiglitz was proven right by later events, but when it mattered the most, the IMF disagreed with him.

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23 With the exception of Indonesia which was overly indebted and experienced a more traditional debt crisis. For more on the Asian crisis, see Ross Buckley, “An Oft-Ignored Perspective on the Asian Economic Crisis: The Role of Creditors and Investors”, (2000) 15 *Banking and Finance Law Review* 431-454.

Eventually, the IMF began to acquiesce to requests by national governments for more expansionary policy settings but by then considerable, unnecessary damage had been done to the East Asian economies.25 The crisis was deepened by the Fund’s initial misdiagnosis and considerable, otherwise avoidable, human suffering was the result. Furthermore, the Fund only altered its views to the extent of easing the austerity it had imposed. In the meantime, Malaysia had adopted more successful strategies that remain outside the Fund’s kitbag of policy options.

Malaysia refused IMF funding and advice in late 1997 and 1998 and chose to chart its own way out of the Asian crisis. The policies Malaysia eventually settled upon were in sharp contrast to the Fund’s. Malaysia imposed capital outflow controls to keep foreign capital within the country, and pegged the ringgit to the U.S. dollar.26 With these policies in place, Malaysia was able to ease monetary policy and pursue expansionary fiscal policies, without being hampered by concerns about the impact on the exchange rate of capital outflows.27

Suddenly Malaysia had created as close to a controlled laboratory experiment as one ever gets in economics. Thailand and Korea were seeking to exit the Asian Crisis using the Fund’s policies, while Malaysia was charting an utterly different course. (I leave Indonesia out of the analysis as its high debt levels means the nature of its problems were quite different and proved to be of much longer duration).

All three economies recovered from the crisis, but Malaysia’s recovery was more rapid, and its poor were harmed far less by its recovery policies than were the poor in countries following the IMF approach.28 In the words of Kaplan and Rodrik, “compared to IMF programs, we find that the Malaysian policies provided faster economic recovery…

27 International Monetary Fund, id, 16.
28 Buckley & Fitzgerald, op cit
smaller declines in employment and real wages, and more rapid turn around in the stock market.”

Yet the Fund’s mistakes in East Asia, so clearly highlighted by Malaysia’s taking the road less traveled, paled in comparison to its egregious errors in Argentina.

**Argentina’s Implosion in 2001**

To put Argentina’s collapse in 2001 into perspective, we need to go back a decade. In 1991 Argentina was emerging from the aftermath of the Debt Crisis and fresh capital was flowing into the country. The years from 1991 to 1998 were prosperous. Argentina’s economy performed strongly. GDP per capita increased 44% in the eight years.  

Inflation was completely under control.

Finally it seemed Argentina’s time had come. It has always had a strong base for an economy: high literacy rates, the best educational system in Latin America and rich natural resources. Now Argentina significantly improved its banking system, more than doubled its exports, privatised a broad range of industries, experienced significant growth in oil and mineral production and achieved record levels of agricultural and industrial output. Argentina in the 1990s was a darling of the IMF and global financial markets. It was toasted as “the best case of responsible leadership in the developing world”.

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30 Miguel Kiguel, “Structural Reforms in Argentina: Success or Failure?”, *Comparative Economic Studies*, XLIV No. 2 (Summer 2002) 83 at 84; percentage calculated from Figure 1. There was a brief hiatus in the growth during 1995 in response to the Tequila effect: the contagion from Mexico’s crisis in late 1994 and early 1995: id at 94-95.

31 Ibid.

32 Sophie Arie, “Rich Argentina tastes hunger”, *The Observer*, May 19, 2002. In the 1930s, on the back of strong beef and grain exports, per capita income in Argentina was on a par with that in France.

33 Kiguel, op cit n 34 at 100-101. This is not to suggest that many of the privatisations were not deeply problematic. It is always a profound challenge to realise appropriate prices for the privatisation of major businesses and assets in emerging markets nations for the range of potential purchasers is not wide and because of the risk of very favourable prices for well-connected purchasers. The scrupulous and rigorous public accountability procedures that would mitigate
Nonetheless at the end of 1998 Argentina entered a severe recession. The timing was dictated in part by external factors, in particular the 1997 Asian economic crisis and the August 1998 Russian crisis which together severely limited capital flows to emerging markets economies. Argentina accordingly had very limited access to new capital to finance budget deficits and service its debt. However, as with the Debt Crisis of 1982, external factors influenced the timing of the crisis, but were not its cause. The causes were excessive borrowing to support general government expenditure, the peg of the peso to the U.S. dollar, and Argentina’s widespread and apparently endemic corruption.

The recession was magnified by massive levels of capital flight, so much so that the government had to impose harsh caps on withdrawals from bank accounts, and eventually, had to close the banks. Still the crisis deepened into a severe crisis in late 2001 when the IMF refused to extend further credit to the nation, believing its economic programs to be unsustainable. As commercial lenders followed this lead, Argentina was denied access to capital and defaulted on its external debt of some US$ 132 billion.

In the year from March 2001 to March 2002, total domestic Argentine financial assets shrunk from US$126.8 billion to US$41.5 billion, according to Business Monitor International. Nonetheless, Argentina was exceptionally resolute in its negotiations with its external creditors and refused to accept conventional levels of debt relief. President Kirchner maintained his refusal to service the debt from the “suffering and hunger of the people”. He had good grounds: Argentina’s poverty rate, 27% in 1999, had doubled by 2003 to 54.7%; per capita GDP, US$7,800 in 1999, had fallen by more

against the latter risk are rarely present. There is much to suggest that many of the privatisations of the 1990s in Argentina were at a deep undervalue.


35 Kiguel, op cit.


39 The Economist, 370, 8365 63 (cited in note 36).
than half by 2004 to $3,800; and debt that represented 47.4% of GDP in 1999, was 140%
of GDP in 2004.\textsuperscript{40}

In the words of an article in The Financial Times, “Argentina gambled, and the gamble
paid off”.\textsuperscript{41} In March, 2005 76% of Argentina’s creditors accepted its offer to exchange
its debt for bonds at the unprecedented discount of some 66 per cent on a net present
value basis.

Argentina emerged from its default on the most advantageous terms ever secured by a
middle-income country in a debt restructuring.

The IMF emerged from Argentina’s collapse with its credibility in tatters. Never before
had a country that had so faithfully followed the Fund’s policies collapsed so severely,
ever before had the Fund’s image been so badly damaged by a sovereign default.

Let’s give the final word on the Washington Consensus policies, as applied by the IMF,
to Professor Hal Scott. As he puts it so clearly, “there is little evidence that IMF
conditions, usually requiring contractionary fiscal and monetary policies, have worked.”\textsuperscript{42}

\textbf{The Socialisation of Private Sector Debt in All Three Crises}

One of the depressingly consistent themes of the aftermath of each financial crisis is the
socialisation of private sector debt – a consequence which the IMF either engineers or to
which it acquiesces.

After the debt crisis broke in 1982 the creditors persuaded each nation to represent all
debtors within its borders in the rescheduling negotiations and to do so by bringing all the
debts of those debtors under its sovereign guarantee. The first step was necessary. The
second was not.

\textsuperscript{40} JF Hornbeck, \textit{Argentina’s Sovereign Debt Restructuring} (cited in note 26).
\textsuperscript{41} Argentina sets a dangerous precedent: The IMF should set tough conditions for further
International Lawyer} 103 at 115.
Bringing all debts under the sovereign guarantee improved the security of the creditors – particularly of the creditors who had made most of the loans to private sector corporations – and these just happened to be the major lenders who were sitting on the creditor steering committees and orchestrating the process. Bringing corporate debts under the sovereign guarantee also represented an utterly unjustifiable charge on the common people of these countries – these loans were ultimately serviced by higher taxes and lower social services.

Fifteen years later in Asia the nature of the crisis was quite different, but the resolution of it was the same – the poor in the debtor countries were shafted – this time by a process engineered by the IMF. The IMF organized bailouts of Indonesia, Thailand and Korea. While described as IMF bailouts of the countries, they were in fact long-term loans made on condition they be used to repay creditors. These loans thus became debts of the nation and the bailouts were of the creditors, not the debtor nations at all. It took four years before bailouts were generally understood to be “a welfare system for Wall Street” as the funds flowed directly through to creditors.

To make matters worse the creditors with debts due typically held short-term bonds – and short-term debt is particularly destabilising for developing countries. So the IMF bailouts encouraged precisely the type of debt that a stable system would discourage.

The idea was that the nations would again take responsibility for the indebtedness of corporations incorporated in the nation, use the loans obtained in the bailout to pay off the foreign creditors, and later recover the debts from the corporate debtors. On average, the Indonesian government recovered some 28% of the value of the loans it incurred on

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behalf of the banking sector.\textsuperscript{47} The other 72\% became a charge on the Indonesian people. And these are large sums of money. The amount of the IMF bailout now represents some 29\% of the total sovereign indebtedness of Indonesia.\textsuperscript{48}

After Argentina’s economic implosion, the international financial community, with the assistance of a compliant Argentine government and the IMF, found two ways to socialise private indebtedness. The first is the familiar IMF bailout, in this case a massive US$40 billion loan to Argentina in late 2000, that was required to be used to repay a mix of public and corporate debt.\textsuperscript{49} The second was a new way to achieve an old end: having the people repay corporate debts. This technique was known as “pesofication”.

Under pesofication, dollar-denominated bank loans and deposits were redenominated in pesos. Banks were required to convert their assets (such as loans) into pesos at a one-for-one rate and their liabilities (such as deposits) into pesos at a rate of 1.4 to 1. This generated huge losses for the banks for which the government sought to compensate them by a massive issue of government bonds of necessarily doubtful value.\textsuperscript{50}

Thus the circle was completed in the usual way in such crises – the ultimate burden fell on the public purse. In the words of Pedro Pou, President of the Central Bank of Argentina until mid-2001, “The government has transferred about 40\% of private debt to workers … We are experiencing a mega-redistribution of wealth and income unprecedented in the history of the capitalist world.”\textsuperscript{51}


\textsuperscript{51}As cited in Gaudin, ibid.
To require the common people to repay corporation’s debts, through increased taxes and reduced government services, is simply immoral. It is a massive interference with the market system that the IMF and the Washington Consensus profess to support. In each of these crises, the market, through the mechanism of bankruptcy, would have allocated the costs of the poor lending and borrowing decisions upon the lenders and borrowers. The IMF, either as architect, or complicit partner, in each case allocated the costs of these poor decisions to parties who had nothing to do with them: the common people of the debtor nations.\(^\text{52}\)

**The Fund’s Inability to Reinvent Itself**

Some will argue that the Fund has learned from the consequences of implementing the Washington Consensus over the past 25 years and it is unfair, and out of date, to indict the organisation on the basis of history. I disagree. There is precious little evidence that the practices of the Fund, as opposed to its rhetoric, have changed significantly at all since 2000.

Throughout the 1990s the Structural Adjustment policies imposed by the IMF on debtor countries were decried by critics for their failure to reduce poverty significantly.\(^\text{53}\) Poverty Reduction Strategy Papers were introduced in 1999 in response to this global outcry and were to contain the policies negotiated between the debtor nation and the Fund that would lead to poverty reduction, and provide the basis for debt relief and access to new funding.

According to the IMF, “PRSPs are prepared by the member countries through a participatory process involving domestic stakeholders as well as external development partners, including the World Bank and the International Monetary


Fund.” \(^{54}\) PRSPs are to outline the economic, social, and structural programs to be used to reduce poverty.\(^{55}\) Instead of focusing on macroeconomic stability and growth like SAPs, PRSPs, as their name suggests, were to put poverty reduction at the core of the nation’s economic policies.

The Fund has its own internal evaluation division, the Independent Evaluation Office, and in March, 2007 it released an Evaluation Report, “The IMF and Aid to Sub-Saharan Africa”\(^{56}\) which evaluated the Fund’s performance in Africa. The Report concluded that there were differences of views among the Executive Board of the Fund about the IMF’s role and policies in poor countries, and that

> “lacking clarity on what they should do on the mobilization of aid, … and the application of poverty and social impact analysis, IMF staff tended to focus on macroeconomic stability, in line with the institution’s core mandate and their deeply ingrained professional culture.”\(^{57}\)

In other words, over seven years after the replacement of SAPs with Poverty Reduction Strategy Papers, and over seven years after the establishment of the Poverty Reduction and Growth Facility, IMF staff were unclear on the priority to be give to poverty reduction and how to achieve it, and so sought to attain that which they knew how to attain, macroeconomic stability. In the first year or two of the introduction of new priorities and programs this would be understandable though regrettable. After seven years this is simply ridiculous. For an institution that is the subject of unremitting criticism for the impact of its programs and policies on poverty, and which has been maintaining steadfastly in all its press releases and public pronouncements since 2000 that poverty reduction is its highest priority, to


\(^{57}\) Quotation is from the Foreward by Thomas A Bernes, Director, IEO, id at vii.
still be trying to bed down new initiatives and priorities on poverty reduction over seven years after their introduction is utterly unacceptable.

The Report also found that the Fund’s policies have accommodated increased aid “in countries whose recent policies have lead to high stocks of reserves and low inflation”, but “in other countries additional aid was programmed to be saved to increase reserves or to retire domestic debt”.58 Very few African countries have high reserves and low inflation. Accordingly, across Sub-Saharan Africa the Fund channelled extra aid into foreign exchange reserves or into debt repayment. Such an approach has two flaws:

1. It diverts extra aid away from healthcare, education or other social welfare expenditures, and
2. It risks being a ‘self-fulfilling prophecy’ as diverting aid flows into reserves and debt reduction is likely to dissuade donors from giving more aid. Most donors want to give aid to directly assist suffering people, not to improve the macroeconomic profile of the nation in which they live.

On the basis of the report by the Fund’s own evaluation office, while the rhetoric of the Fund has changed, in practice its officers still give primacy to macro-economic stability at the expense of assisting the poor and investing in the human capital of a nation.

This short tour of countries subjected, by the IMF, to Washington Consensus policies has been grim reading. Malnourished children in Indonesia, too poor to attend schools. Banks closed in Argentina, giving people without a job no money to buy food. The infrastructure of an entire continent crumbling while money that could have been used to repair roads and telephone exchanges was sent north to service the debts of the debt crisis. In comparison, the stories of growth in China and India, reducing poverty substantially in both countries, are like fairytales of wonder and delight.

**Conclusion**

58 IEO Report, id at 32.
The developed nations should be grateful that China and India managed to ignore IMF advice and policies, and take their own paths, because for some years the stellar economic growth of China and India has lifted that of the world. China’s capacity to produce manufactured goods, clothing and other items ever more efficiently and cheaply has kept a lid on inflationary pressures in virtually all developed economies. For Australia and other minerals exporters China’s growth has provided a massive market for minerals and other commodities. India’s expertise in software development and business processing of all kinds has afforded significant productivity gains to Western corporations. The rise of China and India has had much to do with the global prosperity of the past decade and more.

The success of China and India highlights the weaknesses in the Washington Consensus policies. China and India are two very different nations, with different political systems, development paths, financial systems, and economic policy settings. Yet both nations have far outperformed those implementing Washington Consensus policies. It is arguable that China and India have unique advantages not available to other developing nations. In China, its massive supply of relatively educated, cheap labour and its huge domestic market which China has used adroitly to lure inbound FDI (and ensure high technology comes along with it). In India, the widespread facility with the English language, the English common law legal system and other institutions, and, its tradition of excellence in mathematical and scientific education.

However, these arguments founder when one considers that of the two nations, India’s policies are much closer to those of the Washington Consensus than China’s. Government has a much smaller role in the Indian economy than in China’s. The market is the major allocator of financial and other resources in India, far less so in China. Yet China has consistently outperformed India, and, given the increased investment in its human and physical capital which China’s economic growth has made possible, in particular its rapidly rising investments in education and health, China is likely to continue to outperform from India in the foreseeable future.
In light of the track record of policy failure of the IMF, in East Asia and Argentina in particular, governments in a number of developing countries have been repaying their IMF loans and reclaiming control of their own Treasury policy-making. This trend has been supported by the recent prosperity in many developing countries that has made debt repayment, or refinancing in the private capital markets, possible. Some of these countries have begun to turn to China, and, to a lesser extent, India, for advice on economic policy. This is natural. Success breeds imitators. The IMF’s credibility is at an all-time low in the wake of Argentina’s implosion precisely when China’s is at an all-time high. For years Western experts have been predicting that China’s growth could not continue at its high levels unabated. The weakness of its institutions, such as the rule of law and independent courts, mitigate against sustained growth in Western eyes. But China’s continued growth, far beyond the limits the experts were certain would constrain it, suggests that China may have crafted its own paradigm in which the lessons of institutional economics need to be revised. Whether that system is transferable to other nations, with different work ethics and cultures and levels of entrepreneurship is another matter. What is clear is that the inflexible Washington Consensus policies have not worked, and if the IMF and World Bank don’t revise their policy prescriptions root and branch they are going to become increasingly irrelevant in the contest of ideas.